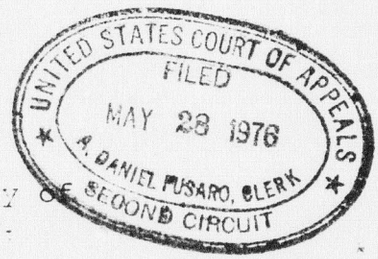
***United States Court of Appeals***

***for the Second Circuit***


# BRIEF FOR APPELLANT

76-5004

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT




ALAN B. MILLER, as Trustee in Bankruptcy of
AMERICAN IBC [illegible]., Bankrupt,

Plaintiff-Appellee,

against

WELLS FARGO BANK INTERNATIONAL CORP.,

Defendant-Appellant.

B P/S

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT, FOR THE SOUTHERN DISTRICT OF NEW YORK

# POST-ARGUMENT BRIEF OF APPELLANT WELLS FARGO BANK INTERNATIONAL CORP.

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## PRELIMINARY STATEMENT

The Appellant, Wells Fargo Bank International Corp. (the "New York Bank") submits this brief in response to the "sur-reply brief" of the Appellee, Alan B. Miller, as Trustee in Bankruptcy (the "Trustee") of American IBC Corp. ("AIBC"), bankrupt, which was served on May 21, 1976, the day of oral argument. During oral argument the Court gave Appellant permission to serve this response.

In addition to the arguments set forth below in reply to the Trustee's contentions, a concise summary of the two transactions at issue, with reference to the findings by the district court, is included as an Appendix for the Court's convenience.

## ARGUMENT

### POINT I

### TWO KEY DIFFERENCES BETWEEN THE FIRST TRANSACTION AND THE SECOND TRANSACTION PERMITTED SILVERSTON TO DIVERT THE FUNDS IN THE SECOND TRANSACTION

Though both transactions were intended to be similar, there were two key differences that permitted Silverston to divert the funds in the second trans-

action. In the first transaction, the New York Bank gave notice of its security interest to its Luxembourg affiliate, which held the time deposit as collateral. The Luxembourg affiliate had accepted the time deposit on the assumption that it was the New York Bank's collateral for its loan. In addition, it directed the Luxembourg affiliate by telex to deliver the proceeds of the time deposit upon maturity to Swiss Credit Bank ("SCB") with explicit instructions to SCB to remit the dollar equivalent to the New York Bank. Furthermore, in the first transaction the New York Bank had the additional protection of controlling the telex key code. Silverston could not tamper successfully with their instructions without the Luxembourg affiliate checking with the New York Bank. Thus, the time deposit with the Luxembourg affiliate was securely "locked in" as collateral.

In the second transaction, the New York Bank failed to give notice of its security interest to United California Bank ("UCB"), in whose name the time deposit was held at SCB; furthermore, it did not control the remittance instructions. These two critical omissions enabled Silverston to divert the proceeds of the time deposit in the second transaction.

Had the New York Bank notified UCB of its security interest in the time deposit and had it con-

trolled the remittance instructions, it would have been impossible for Silverston to divert the New York Bank's collateral in the second transaction. Unfortunately, neither of these precautions were taken.

## POINT II

### THE DOCUMENT ISSUED TO AIBC BY THE LUXEMBOURG AFFILIATE IS MERELY A RECEIPT. NO REASONABLE CREDITOR WOULD BE ENTITLED TO RELY ON IT.

Significantly, the Trustee did not contend before the district court that the time deposit receipt had any meaningful legal significance whatever in the issues in this case.

The Trustee now correctly concedes that under New York law, a potential creditor would not be entitled to rely upon a receipt issued to an individual or a corporation when the receipt merely acknowledges the deposit of money in a bank account. Appellee's "Sur-Reply Brief", pp. 12-13. See First National Bank v. Clark, 134 N.Y. 368, 372 (1892); Appellant's Brief, pp. 24-27; Appellant's Reply Brief, pp. 5-6. However, the Trustee attempts to circumvent this controlling principle of law by two disingenuous contentions. First, the Trustee contends that the receipt issued to AIBC by the Luxembourg affiliate is not really a receipt, but rather is a "time deposit contract". Second, the Trustee, without citing any authority, asserts that if the document issued to AIBC is a "contract", reasonable creditors would be entitled to rely on it in extending credit to the holder thereof. Analysis of both

these contentions establishes otherwise.

First National Bank v. Clark, 134 N.Y. 368, 372 (1892) not only holds that a creditor is not entitled to rely on a bank account receipt, but also sets forth the criteria for determining when a document is a receipt.

> "The appellant calls it a 'certificate of deposit', but such designation is not accurate. It is in fact what the witnesses for both plaintiff and defendant assert it to be, a deposit slip, or deposit check.
>
> The use of the deposit slip is well understood. It constitutes an acknowledgement that the amount of money named therein has been received. It is a receipt and nothing more. No promise is made to pay the sum named on return of the paper; nor is it expected, either by the depositor or depositary, that it will ever be presented to the bank again unless a dispute should arise as to the amount of the deposit, in which event it would become important as evidence. It is not intended to furnish evidence that there remains money in the bank to the credit of a depositor, but to furnish evidence as between depositor and depositary that on a given date there was deposited the sum named." 134 N.Y. at 372 [Emphasis supplied]

A review of the deposit slip (Ex. 3) establishes that it conforms to the definition in First National Bank v. Clark, supra. No promise is made to pay the sum named upon return of the paper. It is only evidence between the depositor and the depositary that on a given date there was deposited the sum named.

The testimony of Charles E. Lilien, the executive vice-president of the New York Bank, confirms that the document (Ex. 3) is a receipt and nothing more.

> "This is a form which can best be described as a confirmation of a transaction and it is designed to permit our bank in Luxembourg to be sure that its records conform accurately to the records of the customer so that there can be no question about the fact that the records are viewed identically by both parties." Tr. pp. 253-54

This uncontested testimony about the significance of the document issued to AIBC is completely analogous to the nature and bookkeeping function of a deposit slip as outlined in First National Bank v. Clark, supra, at 372.*

On page 13 of the Trustee's sur-reply brief, the Trustee states: "[T]he time deposit contract used by Wells Fargo Luxembourg is expressly labelled 'Contract'." This statement is misleading as clearly shown by an examination of Exhibit 3 (E 5). The only reference to a contract on the receipt is found in the upper left hand corner of the document which states "Contract No. 42781".

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*Any distinction between the document issued in this case and the deposit slip involved in First National Bank v. Clark, as suggested by the Trustee, on the basis of the fact that the present case involves a time deposit account, while Clark involved a checking account, is unfounded. The money in the account kept with the Luxembourg affiliate could have been withdrawn in the instant case immediately after the deposit just as in the Clark case. The depositor in each case would still retain the document even after the withdrawal, since payment of the amount in the account was not conditioned on surrender of the receipt.

This reference, which corresponds to the account number found on ordinary deposit slips, does not alter either the nature or the significance of the receipt issued to AIBC.

Furthermore, the Trustee's ultimate conclusion that reasonable creditors could rely on the document in extending credit is untenable.* A mere "contract", unless it is in the nature of an "indispensable instrument", does not give the holder thereof the right to control any funds. See Annot., 53 ALR2d 1396 §8 (1957). The Trustee does not contend that this document is an "indispensable instrument", and it patently is not. [Opinion, A 182] Under First National Bank v. Clark, supra, a document would have to be an "indispensable instrument" before creditors would be entitled to rely on it.

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*The Trustee cites no authority for this conclusory statement which he makes in his sur-reply to Appellant's Brief, p. 13.

## POINT III

### THE DISTRICT COURT'S CONCLUSION THAT AIBC COULD COMMUNICATE WITH THE LUXEMBOURG AFFILIATE DOES NOT DETRACT FROM THE TELEX KEY CODE'S FUNCTION AS AN INDISPENSABLE INSTRUMENT

If we assume that possession of an indispensable instrument is essential for the pledge of a time deposit account, then under international banking practice the telex key code constituted such an instrument. The district court found that AIBC could have communicated by other means with the Luxembourg affiliate, and therefore concluded that the telex key code did not constitute an indispensable instrument. [Opinion, A 180, n. 13] However, the question of communication by other means is totally irrelevant.

The test for determining whether an instrument is "indispensable" is whether the instrument is the primary means of affecting the disposition of the underlying intangible.* Restatement of Security §1, Comment e (1941). In the instant case, the district court failed to apply this test in rejecting the New York Bank's contention that the telex key code constituted an indispensable instrument.

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* In the absence of the indispensable instrument, the underlying funds could be affected only by accounting for the absence of the instrument and obtaining as a substitute for it either a duplicate or some form of court decree. Restatement of Security §1, Comment e (1941). See Appellant's brief, p. 28.

Specifically, the record in this case is uncontroverted that the telex key code was the primary means by which the funds with the Luxembourg affiliate could have been affected. [Tr. pp. 250-53] As stated by Charles Lilien at trial, in reference to the telex instructions:

> "Q. When you describe the transaction as a secured transaction, would you state, Mr. Lilien, how the first transaction was secured?
>
> A. Yes. In the case of the first transaction the time deposit established in the name of American IBC at Wells Fargo Bank Luxembourg was secured by the specific pledge of that deposit as collateral to the bank and further by the fact that it was Wells Fargo Bank International which communicated with Wells Fargo Luxembourg to establish the deposit and was the only vehicle that could be used to communicate on the subject of the deposit because the client, American IBC did not have any direct communication facilities that could be verified at Wells Fargo Bank Luxembourg.
>
> Q. In other words, even if American IBC wanted to do something with that time deposit at Luxembourg they could not, is that right?
>
> A. They could not have.
>
> Q. The only movement of that time deposit would be through your bank?
>
> MR. MILLER: I object to the questions.
>
> THE COURT: You are doing what Mr. Miller did, testifying for the witness. I will give it the same weight that I gave to his testimony.

Q. Could that time deposit be moved other than through your bank, sir?

A. No. Wells Fargo Bank Luxembourg would have required something that they could use as a verifiable evidence of the authenticity of any instruction and since we were the people who had established that deposit with them they would not have been able to verify instructions from any other source." [Tr. pp. 250-52]

Silverston, the Trustee's witness, described the function of the telex key as follows:

Q. Mr. Silverston, why did you instruct Mr. Boland to make that request?

A. We had no means of communicating with Wells Fargo Luxembourg other than by letter with verified signatures. We had no test key with them so we asked Wells Fargo New York to do it.

Q. When you say Wells Fargo New York you are talking about Wells Fargo International?

A. Yes.

Q. Wells Fargo Bank International had a test key?

A. Yes.

Q. What is a test key?

A. A test key is a document which yields a number. It is derived by a separate number being assigned for each total sum of figures, an additional number being assigned for the day of the month, an additional number for the day of the week, an additional number for the ordinal number of the message sent that day and a fixed key between

> the two parties. So that when an amount is sent telegraphically or communicated between two parties it can be verified by each party having a copy of the key and generally the beginning of the message it will be a test with a number and then you take the total sum added together with the time and days of the week and if it equals that it is verification that it has come from the party who is supposed to be sending it. We had no such key at Wells Fargo Luxembourg." [Tr. pp. 32-33]

The communications by mail referred to by the district court in no way involved the disposition of the funds held by the Luxembourg affiliate. This communication was simply a request for acknowledgment of the time deposit receipt mailed earlier. [Opinion, A 180, 181 n. 13; Ex. 4 (E 6)] Thus, under the test set forth in the Restatement, and in light of the uncontroverted testimony at trial, the district court erroneously concluded that the telex key code in the New York Bank's possession was not an indispensable instrument.

Moreover, the fact that a representative of AIBC might have obtained the documents or signature cards necessary to obviate the need for the Bank's telex does not dictate otherwise. As previously noted, an indispensable instrument is no less indispensable because a person can obtain a substitute for it by accounting for its

absence. Restatement of Security §1, Comment e (1941). For example, the loss of a savings bank book or a stock certificate does not necessarily deprive the owner of the right to the underlying asset. The savings bank or the corporation which issued the stock may require certain alternate procedures, i.e., an affidavit of loss, and an indemnification agreement or bond from the depositor or stockholder. If the savings bank or corporation is satisfied with the alternate procedures the need for the "indispensable instrument" can be eliminated.

In any event, the record establishes that had Silverston attempted to affect the disposition of the funds without the telex key code, the Luxembourg affiliate would have required verification from the New York Bank.

> "Q. You testified, Mr. Lilien, that if Mr. Silverston or American IBC attempted to get that time deposit there would have been some problem at Wells Fargo Luxembourg?
>
> A. Yes, that is right.
>
> Q. How do you know that?
>
> A. Because banks will not move funds unless they are satisfied as to the validity of the instructions being received.
>
> Q. That is a surmise or a conjecture?
>
> A. Standard banking practice." [Tr. p. 272]

This was especially true in this case because the New York Bank had informed its Luxembourg affiliate that the time

deposit was collateral for the loan.

Even if the telex key code does not constitute an indispensable instrument, the Luxembourg affiliate (the New York Bank's agent) had possession of the underlying funds.

The following conclusion by the district court is appalling in light of the record and commercial reality:

> "The defendant Bank also attempts to circumvent the indispensable instrument requirement by suggesting that the subject of the pledge was the Swiss Francs themselves, not the time deposit. Unless words are not to be taken to mean what they say, however, there is no evidence in the record that AIBC and the New York Bank agreed that the Swiss Francs themselves would be pledged to secure the loan." [Opinion, A 181 n. 13]

If the underlying Swiss francs in the time deposit were not pledged as collateral, what was? The attempted separation of the obligation to pay a time deposit at maturity from the underlying funds in this fact situation is an amazing piece of sophistry. The parties clearly intended the pledge of the time deposit, with both elements, as collateral.

## POINT IV

### THE TRANSFER OF THE PROCEEDS OF THE LUXEMBOURG TIME DEPOSIT TO THE NEW YORK BANK DID NOT RESULT IN A LOSS OF THE NEW YORK BANK'S SECURITY INTEREST

It is frequently necessary for a secured creditor to temporarily relinquish collateral for the purpose of sale or exchange. In recognition of this business necessity, both the New York U.C.C. §9-306(3) and common law provide that a creditor may temporarily release pledged collateral without losing his security interest. See Appellant's brief, pp. 33-39; Appellant's reply brief, pp. 23-26.

Whenever collateral is temporarily released to the pledgor or a third party, the pledgor or the third party can ignore the special and limited purposes for which the collateral was released to him. He has the opportunity to convert it and transfer it or its proceeds to a third party. In addition, third-party creditors of the pledgor may seek to obtain attachments on the pledged collateral while it is in the pledgor's possession. However, as long as the pledgee only releases the collateral for a temporary or specific purpose, neither of these possibilities causes a break in the pledgee's security interest.

Therefore, even if it is assumed theoretically either that creditors of AIBC could have attached the funds when they were in international bank clearing channels, or that AIBC could have somehow converted the funds, the New York Bank still retained a continuous security interest.

In addition, as the court noted in Harrison v. Merchants National Bank, 124 F. 2d 871 (8th Cir. 1942):

> "A pledgee may employ the pledgor as his agent to sell goods held in pledge and he does not lose his lien by allowing the pledgor to contract in his own name for the sale, or by delivering the goods on his order to the purchaser." 124 F. 2d at 874."

Therefore, even if the New York Bank did deliver the Swiss franc proceeds of the matured time deposit to the purchaser of them (SCB) for conversion into dollars pursuant to AIBC's request, it did not lose its security interest. Also, the fact that AIBC gave additional instructions to SCB to pay the dollars to the New York Bank does not matter because, as noted above, the pledgee does not lose its lien even if it permits the pledgor to contract in its own name.*

Moreover, the transfer of funds in the present case was made pursuant to the instructions issued by the

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*In any event, the remittance instructions from the Luxembourg affiliate controlled the flow of funds.

New York Bank. Simply because AIBC requested the New York Bank to issue these instructions does not alter the fact that the Luxembourg affiliate was the sender; and the district court specifically found for the purposes of its decision, that the Luxembourg affiliate was the New York Bank's agent. More importantly, this request indicates that AIBC realized that the New York Bank had complete control of the time deposit and that instructions from the New York Bank were necessary to move the funds.

Finally, the transaction was essentially a bank clearing transaction. It was controlled by the remittance instructions issued by the Luxembourg affiliate acting on orders from the New York Bank. If the Trustee's argument is accepted, it means that every bank transfer of funds through a clearing bank without notice of a security interest results in a loss of that security interest.

The clearing system (See the DiGioia affidavit E 135-139) is essentially a mechanical one which banks use to send their funds. It is analcgous to a postal service used to send funds or property by mail, or an airline, steamship or other contract carrier. No one would ever suggest that a creditor would have to notify the Post Office Department of his security interest in collateral when he sends collateral through the mail or else run the risk of a loss of that security interest. Yet, it is exactly this

type of argument that is being advanced by the Trustee here.

The only thing a lien creditor could have attached was AIBC's account at SCB. However, the district court found that the funds in question did not flow through AIBC's account at SCB.

> "The parties initially addressed this issue under the impression that the Swiss Bank processed the currency exchange on November 2 by contemporaneously debiting and crediting AIBC's account at the Swiss Bank, so that the transaction might be deemed to have returned the pledged property to AIBC, the pledgor. The parties appear to have dropped the issue when further factual analysis revealed that AIBC's account was not involved in the transaction on November 2, see note 2, supra. . . ." [Opinion, note 17]

In any event, the question of whether a third party could have attached these funds, or whether AIBC could have converted them, is simply irrelevant. As noted above, a third-party creditor may try to obtain an attachment on collateral; and the pledgor may convert it in any instance where it is temporarily released to the pledgor for the purpose of sale or exchange. But regardless of these facts, the pledgee retains his continuous security interest. This conclusion is even more compelling here because the interruption claimed by the Trustee is the simultaneous transfer of funds through bank clearing channels.

## POINT V

### AFTER AUGUST 29, THE TRUSTEE OF AIBC COULD NOT RECOVER THE FUNDS HELD BY SCB -- THEREFORE, THE SUBSEQUENT TRANSFER OF THESE FUNDS TO THE NEW YORK BANK DID NOT RESULT IN A DIMINUTION OF AIBC'S ESTATE

In his "sur-reply brief", the Trustee devotes some seven pages and long quotations to the question of when a "transfer" is made. The fact that a "transfer" was made on November 19, 1973 has never been an issue. The issue is whether the funds transferred could have been recovered by the Trustee in Bankruptcy. Only in this case would a diminution have occurred.

In the second transaction, AIBC deposited the Swiss francs which it had purchased from SCB on May 17, 1973 in a time deposit at UCB's account at SCB. [Ex. 40 (E 99-100)] Therefore, SCB had physical possession of the funds. In June, 1973, AIBC "irrevocably" instructed UCB to pay the Swiss franc proceeds of the time deposit on maturity to SCB. [Ex. 40 (E 103)] In July, SCB requested confirmation from UCB that its instructions to pay the proceeds of the time deposit to SCB were "irrevocable". [Opinion, A 163; J.F.F. 44 (A 23)] On July 19, UCB advised SCB that its instructions from AIBC were "irrevocable". [Ex. 40 (E 113); J.F.F. 47 (A 24)] SCB already had instructions to exchange the Swiss

franc time deposit proceeds into dollars. [J.F.F. 35 (A 21), 41 (A 22)]

On August 29, 1973, AIBC telexed SCB and authorized it to utilize the dollar proceeds of the forward foreign exchange contract to repay SCB's advances to AIBC. [Ex. 19 (E 41); Ex. Q (E 196)] As a result of this telex, SCB obtained a lien on the dollar proceeds of the foreign exchange contract. [Opinion, A 170; Opinion of Dr. Kliener, A 81]

Therefore, as of August 29, 1973, all the elements of the transaction were entirely in SCB's possession or under its control: (1) the Swiss francs in the second time deposit were located at SCB in the name of UCB; (2) UCB was irrevocably instructed to pay the proceeds of this time deposit to SCB upon maturity; and (3) on August 29, 1973, SCB obtained a lien on the dollar proceeds of the forward foreign exchange contract.* It is clear that had SCB retained the dollars, the Trustee could not have recovered them.

Therefore, the question at issue is whether a diminution of the bankrupt's estate occurs when a creditor of

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* The agreement between AIBC and SCB explicitly provided:

> "The Bank has a right of lien on all assets whether in its own custody or placed elsewhere for client's account..." [A 119]

The result is the same under New York law. See Appellant's Reply Brief, p. 31.

that bankrupt, within four months of bankruptcy, transfers funds to another creditor which could not be recovered by the Trustee of that bankrupt. All the cases dealing with this question hold that there is no diminution of the debtor's estate. In re Erie Forge & Steel Corp., 456 F.2d 801 (3rd Cir. 1972); Ricotta v. Burns Coal & Building Supply Co., 264 F.2d 749 (2nd Cir. 1959); Grubb v. General Contract Purchase Corp., 94 F.2d 70 (2nd Cir. 1938); LaBour v. Allen, 165 F. Supp. 471 (W.D. Mich. 1958); 3 Collier, §60.26, p. 880. See also Virginia National Bank v. Woodson, 329 F.2d 836, 839 (4th Cir. 1964).

The Trustee's only other argument is that the bookkeeping entries by which the funds in question were credited and then debited from AIBC's account constituted a return of the funds to AIBC's estate. McKenzie v. Irving Trust Co., 292 N.Y. 347, 359, aff'd, 323 U.S. 365, 371-72 (1945), held that bookkeeping entries of this type do not constitute a return of the funds to the bankrupt.

In addition, McKenzie is buttressed by United States v. Sterling National Bank & Trust Co., 494 F.2d 919 (2nd Cir. 1974), a case mentioned by the Trustee in oral

argument.* In Sterling, this Court found that funds are a depositor's property if he is entitled to withdraw them. 494 F.2d at 922. In denying the New York Bank's setoff defense, the district court specifically held that AIBC was not entitled to withdraw these funds when the New York Bank made its simultaneous credit and debit entries on November 19, 1973.** [Opinion, A 135-36] Therefore, under the explicit holding of McKenzie and the logic of Sterling, these simultaneous debit and credit entries did not constitute a return of the funds to AIBC's estate.

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* The Trustee cited the Sterling case for the proposition that a creditor could have attached the proceeds of the Luxembourg time deposit when they were remitted back to the New York Bank. That case stands only for the obvious proposition that a creditor may attach funds in a checking account. However, since the district court found that the proceeds of the Luxembourg time deposit did not flow through AIBC's account at SCB [Opinion, A 182, n 17], that case is inapplicable to the instant case.

** If AIBC was entitled to withdraw these funds, then the New York Bank properly exercised its right of setoff.

## POINT VI

## THE TRUSTEE HAS FAILED TO MEET HIS BURDEN OF PROOF REQUIRED TO ESTABLISH THAT THE NEW YORK BANK HAD REASONABLE CAUSE TO BELIEVE THAT AIBC WAS INSOLVENT AT THE TIME OF THE REPAYMENT OF THE LOANS IN QUESTION

The Trustee has the burden of proving that the New York Bank had reasonable cause to believe that AIBC was insolvent at the time of the repayment of the two loans in question. [Opinion, A 127]; First National Bank v. Julian, 383 F.2d 329, 333 (8th Cir. 1967); Lang v. First National Bank, 215 F.2d 118 (5th Cir. 1954); 3 Collier, ¶60.36 at 913 (14th ed. 1975). The record clearly establishes that the Trustee did not meet this burden as a matter of law.

In holding that the New York Bank did have reasonable cause to believe AIBC was insolvent, the district court found that the New York Bank had a duty to investigate AIBC's financial affairs in April and May, 1973 before the loans were made when the New York Bank first became aware of a dispute with Silverston's Colombian partners. [Opinion, A 129] Counsel for the Trustee has asserted that the New York Bank "deliberately closed its eyes" to the financial

condition of AIBC before the loans were made. This amazing assertion is not only contrary to the fact but flies in the face of common sense. The record is clear that the New York Bank would not deal with an insolvent customer as a matter of policy. [Tr. p. 266] At the same time, a bank cannot be charged with "20-20 foresight" as to the eventual impact of each and every problem a customer may have. To do so would charge the New York Bank with an ongoing duty of investigation of each and every customer's problem.

International Minerals & Chemical Corp. v. Moore, 361 F.2d 849 (5th Cir. 1966), rejected the theory that a creditor has an ongoing duty of investigation. There the court found that even if the creditor (International) had reasonable cause to believe the debtor was insolvent in 1960, that did not mean it had "reasonable cause to believe" the debtor was insolvent in 1961 when it was paid.

> "Even the fact, if it be a fact, that in 1959 or early 1960 International may have had reason to suspect that a transfer then would have effected a preference, is not to say that such a belief, or reasonable cause therefor, would still exist in December, 1961 without cogent proof." Supra at 853-54.

If knowledge of insolvency at one point in time creates an ongoing duty to investigate, as the Trustee and the district court suggest, then knowledge of insolvency should have been imputed to the creditor in International Minerals & Chemical Corp. v. Moore, supra. However, the Court of Appeals refused to do so in that case and reversed that district court's finding that "reasonable cause to believe" existed.

As the Court in International Minerals & Chemical Corp. v. Moore, supra, pointed out, the question at issue is whether or not the creditor had reasonable cause to believe that the debtor was insolvent at the time it was repaid. Therefore, the question here is whether the facts that came to the New York Bank's attention on or just prior to the dates of repayment were sufficient to create a reasonable cause to believe AIBC was insolvent.

The district court found:

> "AIBC was not responsive to the Bank's request for financial statements for the 1973 fiscal year; indeed, the very Dun and Bradstreet report the Bank relies upon indicated that the bankrupt had 'declined all financial information'. Moreover, AIBC did not answer the Bank's belated request, in August 1973, for a signed promissory note in connection with the second loan which had been granted the preceding May. Finally, while relevant only to the second loan payment, the

> Bank learned on November 9 and 11, 1973 in the course of its general credit check that Chemical Bank had closed AIBC's account and that National Bank of North America refused to comment on its relationship with the company." [Opinion, A 142]

These facts are not sufficient as a matter of law to establish that the New York Bank had reasonable cause to believe that AIBC was insolvent.

In Moran Bros. Inc. v. Yinger, 323 F.2d 699 (10th Cir. 1963), the district court below had found that:

> (1) The requirement by the creditor of an escrow deposit;
>
> (2) The failure of the debtor to make the deposit after stating that the funds were not available; and
>
> (3) The tender of a postdated check and subsequent refusal to make payment because of insufficient funds,

constituted "reasonable cause to believe". The Court of Appeals reversed, stating:

> "The most that can be said for the evidence in the light of the foregoing principles of law is that it tends to give rise to an apprehension or suspicion of insolvency and, as we have seen, apprenension or suspicion does not amount to reasonable cause." 323 F.2d at 702.

Dean v. Planters National Bank of Hughes, 176 F. Supp. 909 (E.D. Ark. 1959), listed some of the recurring factors that seem to constitute "reasonable cause to believe":

> ". . . undercapitalization of the debtor, sales below cost, checks drawn on a bank account and repayment refused by reason of insufficient funds, a consistent pattern of overdrafts, operating losses, irregular, unusual or criminal conduct, secretiveness, slow payment, collection measures taken by other creditors, rescue of the debtor from embarrassment by friends or relatives or reports." 176 F. Supp. at 914.

Silverston's conversion of the funds in the second transaction came to light only after the loan was repaid.

The above facts, found by the court in the present case, (see page 24, supra) fall far short of what the courts have found to be necessary to constitute "reasonable cause to believe" a debtor is insolvent. This is especially the case in light of the district court's additional findings that the New York Bank knew:

(1) The loans were repaid on the dates due and in the manner anticipated. [Opinion, A 128]

(2) Reported difficulties in South America were investigated, and both the bank's representatives and AIBC reported they had been cleared up. [Opinion, A 129]

(3) A general credit check completed on November 15, 1973 produced no adverse reports. [Opinion, A 128]

(4) The New York Bank, on October 3, 1973, received a Dun & Bradstreet regular report on AIBC. In addition, revised special reports had been forwarded to the New York Bank by Dun & Bradstreet. None of these reports covering 1973 mentioned any litigation against AIBC or any substantial losses. [Opinion, A 129]

(5) Officers of the New York Bank, shortly before repayment, recommended that other bank clients use AIBC's services. [Opinion, A 178 n. 8]

(6) The New York Bank's previous experience with AIBC had been good. [See Tr. p. 151]

(7) The Lobanov letter and Lilien's memorandum indicating that AIBC was in difficulty were written after the repayment. [J.F.F. 60, 61 (A 27); Ex. T (E 205)]

These facts, viewed individually or collectively, clearly do not warrant a conclusion that the New York Bank even had any suspicion, let alone "reasonable cause to believe", that AIBC was insolvent at the time the second loan was repaid.

## CONCLUSION

1. The first loan was secured by an assignment to the New York Bank of the time deposit located at the Luxembourg affiliate;

2. The first loan was also secured by a pledge of the Luxembourg time deposit to the New York Bank;

3. The transfer of the proceeds of the Luxembourg time deposit account to SCB for the limited and special purpose of exchanging the francs for dollars did not result in a loss of the New York Bank's security interest;

4. The repayment of the second loan to the New York Bank did not result in a diminution of AIBC's estate; and

5. The Trustee did not meet his burden of proof required to establish that the New York Bank had reasonable cause to believe that AIBC was insolvent at the time of the repayment of the loans in question.

Thus, for the reasons stated in Appellant's briefs this Court should reverse the district court's decision.

Respectfully submitted,

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## APPENDIX

For the Court's convenience, an outline of the relevant facts relating to the two arbitrage transactions in issue, with reference to the district court's findings [Opinion A, 121-22, 174-75 n. 1], is presented below. It should be noted that appellant New York Bank is not in basic disagreement with the district court's findings of fact, but rather with the legal conclusions drawn from these facts.

### The First Loan Transaction

In April, 1973 AIBC approached the New York Bank with a proposal that it finance a currency arbitrage transaction involving dollars and Swiss francs. By taking advantage of a difference in the present ("spot") and future ("forward") exchange rates between the two currencies, AIBC was guaranteed a profit with no concurrent risk. [Opinion, A 121] After some preliminary negotiations, the New York Bank agreed to loan AIBC $1,000,000 for six months on a secured basis. [Opinion, A 121-22; J.F.F. 10 (A 16)]

All of the elements of the transaction were established at its inception. The transaction was structured so that it would "unwind" automatically six months hence. The transaction was secured and self-liquidating.

There was no risk of loss if the exchange rate between the dollar and the Swiss franc fluctuated either "spot" or "forward" between May 2, 1973 and November 2, 1973. AIBC had firm exchange contracts for the "spot" exchange of dollars into Swiss francs and the "forward" exchange of Swiss francs into dollars. Both the "spot" exchange and the "forward" exchange were made through SCB, which made the market in the two currencies.

The transaction was profitable for AIBC because of the "spread" in exchange rates for "spot" and "forward" Swiss franc/dollar transactions. At the time of the transaction, on May 3, 1973, the "spot" exchange rate was 3.24 Swiss francs for each American dollar. At the same time, the six month "forward" exchange rate was 3.173 Swiss francs for each American dollar. The spread between "spot" and "forward" rates was great enough to cover the excess of the interest AIBC paid on its loan from the New York Bank as against the interest it received on the Swiss franc time deposit. Thus an investor like AIBC was assured of a profit by buying a certain amount of francs on May 3, 1973 and contracting to sell the same number of francs for dollars six months in the future.*

* For example, an investor investing $1,000 could purchase 3,240 Swiss francs on May 3, 1973. By contracting to sell the francs for dollars six months in the future, the investor would need to use only 3,173 of the francs to recoup his original investment of $1,000. The remaining 67 Swiss francs in his possession would be profit; if we assume he contracted on May 3, 1973 to exchange those Swiss francs six months in the future, the profit in dollars would come to approximately $22.03. Of course, to the extent that larger amounts of dollars were invested, the profit would be that much greater.

In our situation, and without using any of its own funds, AIBC made a guaranteed profit of $2,369.*

AIBC used the dollars it received from the New York Bank to purchase on the same day 3,240,000 Swiss francs for SCB in Zurich, which it then resold for dollars for delivery six months later. In the interval, in order to secure the New York Bank, AIBC, through the New York Bank's telex facilities, deposited the Swiss francs in a six month interest-bearing time deposit with the Luxembourg affiliate. [Opinion, A 174 n. 1; J.F.F. 16, 17, 18 (A 17-18)] A receipt was subsequently issued to AIBC acknowledging deposit of the funds with the Luxembourg affiliate [Ex. 3 (E 5)].

The Luxembourg affiliate was notified that this deposit was lodged as collateral to secure payment of the New York Bank's loan. [Opinion, A 139, 141; Ex. H (E 186); Tr. p. 155] The Luxembourg affiliate was also instructed, via the New York Bank's telex facilities, to transfer the Swiss francs, comprising the time deposit, to SCB when the

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* AIBC's profit turned out to be slightly greater. The Luxembourg affiliate quoted an interest rate of 3 1/8% on the collateral time deposit; and the "forward" contract with SCB was made on the assumption that the collateral deposit would increase at the rate of 3 1/8%. At the last minute the Luxembourg affiliate increased its interest rate to 3 1/4%. Accordingly, on November 2, 1973 it sent 3,309,997.50 Swiss francs to SCB with an instruction to remit the dollar equivalent to the New York Bank. SCB converted the 3,308,850 Swiss francs originally agreed upon and sent dollars $1,042,814 to the New York Bank.

time deposit was scheduled to mature on November 2, 1973. [Ex. 46 (E 122; J.F.F. 20 (A 18)] SCB was in turn instructed by the Luxembourg affiliate, acting for the New York Bank, to exchange the francs for dollars, and transfer the dollars to the New York Bank for AIBC's account: "Att. mr. Ribi. Instructions: remit dollar equivalent to Wells Fargo Bank Int. New York. Att. mr. Boland in favor of AIBC." [Ex. AD (E 221)]

The transaction proceeded as planned. When the Swiss franc time deposit matured on November 2, 1973, the francs were delivered to SCB. After converting the francs into dollars, SCB, pursuant to instructions it received from the Luxembourg affiliate, forwarded the dollars to the New York Bank for AIBC's account. [Opinion, A 174 n. 1; J.F.F. 22, 23 (A 19)]

The New York Bank credited AIBC with the dollars and simultaneously debited AIBC's account $1,040,666.67, representing the principal and interest due the New York Bank; AIBC's account retained a profit of $2,147.70 which arose from the differential in the two rates of exchange, as reduced by the differential in the rates of interest it paid for the borrowed funds and received for the time deposit. [Opinion, A 174 n. 1; J.F.F. 25 (A 19)]

The Second Loan Transaction

Shortly after the May 3, 1973 loan, AIBC through

its president, Silverston, requested the New York Bank to finance a second arbitrage transaction on essentially the same economic terms as the first. The New York Bank agreed. [Opinion, A 157, 174 n. 1; J.F.F 28 (A 20)] The parties clearly intended the second transaction to be a secured transaction as was the first, and the district court so stated. [Tr. p. 370]

AIBC borrowed another $1,000,000 on May 17, 1973, due November 19, 1973. Concurrently, AIBC purchased 3,130,000 Swiss francs from SCB and contracted with SCB to exchange the francs into dollars on November 19 at a fixed rate, favorable to AIBC. [Opinion, A 174 n. 1; J.F.F. 31-34 (A 20-21)]

In the interval, AIBC placed the Swiss francs in a six month interest-bearing time deposit in the name of UCB at SCB. [Opinion, A 174 n. 1; J.F.F. 35, 37 (A 21-22)] After the dollars were exchanged into Swiss francs, they never left the possession of SCB. [Ex. 40 (E 99-100); J.F.F. 29 (A 20)] As was the case with the first loan, the parties intended that this time deposit serve as collateral for the May 17 loan made by the New York Bank to AIBC. [Tr. p. 370; Exs. B (E 176), C (E 178), D (E 179), E (E 180)]

UCB was instructed to pay the Swiss francs to SCB on November 19. SCB was in turn instructed to exchange the francs into dollars and to transmit the proceeds to the New York Bank. [J.F.F. 40-41 (A 22)]

Apart from the above transactions, AIBC was indebted to SCB in the amount of $940,603.23. [J.F.F. 56 (A 26)] On June 19, 1973, UCB confirmed by letter to SCB that it had been instructed by AIBC to repay the Swiss francs to SCB. On June 25, 1973, SCB acknowledged receipt of the confirmation from UCB. SCB subsequently telexed UCB on July 16, 1973 requesting confirmation that UCB would "irrevocably" deliver the Swiss francs to SCB. On the same day, UCB telexed SCB explicitly stating that such instructions were "irrevocable" [J.F.F. 42-45 (A 23)]

On August 29, 1973, AIBC authorized and instructed SCB to apply the proceeds of the UCB time deposit when received on November 19, 1973 in repayment of all dollar advances by SCB to AIBC. The New York Bank was unaware of the change of instructions to SCB. [Opinion, A 166; J.F.F. 57, 58 (A 26)]

Despite these revised instructions, however, the transaction proceeded as originally planned. When the time deposit matured, UCB transmitted the Swiss francs to SCB for exchange into $1,046,894.05. The latter sum was then sent to the New York Bank for AIBC's account. The New York Bank credited AIBC with the dollars and simultaneously debited AIBC's account $1,043,916.67 in repayment of the principal and interest due the New York Bank for the May 17 loan. The remaining $2,944.38 was left in AIBC's New York account

as its profit on the transaction. [Opinion, A 174 n. 1; J.F.F. 53 (A 25)]

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